

PRESENTATION FOR HIGHER EDUCATION COMMISSION

OVERVIEW OF RESEARCH & DEVELOPMENT TAX INCENTIVES

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August 2, 2010

Federal R&D Incentives

The Credit

- The federal research and development credit, which is allowed under Internal Revenue Code (“IRC”) § 41, is designed to encourage businesses to increase the amounts they spend on research and experimental activities.
- The credit applied to qualified research paid or incurred on or before December 31, 2007, but Congress let the credit expire. However, the credit was retroactively restored late in 2008 for expenditures made from January 1, 2008 through December 31, 2009.
- The credit has not yet been extended, but there have already been efforts to do so this year in Congress.

Federal R&D Incentives

The Credit, Cont.

- The R&D credit is generally 20% of the amount by which research expenses for the year are higher than the base period amount in addition to 20% of the basic research payments and 20% of the amounts paid or incurred by the taxpayer in carrying on any trade or business of the taxpayer during the taxable year (including as contributions) to an energy research consortium for energy research.

Federal R&D Incentives

The Credit, Cont.

- In order to qualify for the credit, the research must be technological in nature and must be intended to be useful in the development of a new or improved business component. Further, it must relate to a new or improved function, performance, reliability, or quality.

Federal R&D Incentives

Alternative Incremental Credit

A taxpayer could elect to claim this alternative credit prior to January 1, 2009. The rates used to calculate the three tiers of this credit were:

- 3% of the portion of the qualified research expenses that exceed 1%, but not more than 1.5% of the average annual gross receipts for the 4 preceding tax years;
- 4% of the portion of the qualified research expenses that exceed 1.5%, but not more than 2% of the average annual gross receipts for the 4 preceding tax years; and
- 5% of the portion of the qualified research expenses that exceed 2% of the average annual gross receipts for the 4 preceding tax years.

Federal R&D Incentives

Alternative Simplified Credit

A taxpayer may still elect to claim this simplified credit. The credit is currently equal to 14% of so much of the qualified research expenses for the taxable year as exceed 50% of the average qualified research expenses for the 3 taxable years preceding the taxable year for which the credit is being determined.

Federal R&D Incentives

The Deduction

Under IRC § 174, a taxpayer may choose to deduct research or experimental expenditures which are paid or incurred by him during the taxable year in connection with his trade or business.

Virginia Income Tax R&D Incentives

Subtraction

A corporate and individual income tax subtraction exists for the amount of "qualified research expenses" or "basic research expenses" eligible for deduction for federal purposes, but which were not deducted because the taxpayer elected to claim the federal credit instead.

Virginia Income Tax R&D Incentives

Qualified Equity and Subordinated Debt Investments Credit

- This credit was amended in 2009 to encourage investment in companies focused on commercializing research developed at or in partnership with universities.
- The credit is now allowed to individuals or corporations for investments in businesses related to advanced computing, advanced materials, agricultural technologies, biotechnology, electronic device technology, energy, environmental technology, medical device technology, nanotechnology, or any similar technology-related field.
- For taxable year 2010, the cap on this credit has been increased from \$3 million to \$5 million.

Virginia Income Tax R&D Incentives

R&D Credits – Tobacco

- Virginia previously had two credits related to research and development in tobacco-dependent localities, but they expired as of January 1, 2010.
- While the credits were in existence, they were never funded by the Tobacco Indemnification and Community Revitalization Fund, and thus were never active.

Other Virginia R&D Tax Incentives

Retail Sales and Use Tax

A Retail Sales and Use Tax exemption exists for tangible personal property purchased for use or consumption directly and exclusively in basic research or development in the experimental or laboratory sense.

A Retail Sales and Use Tax exemption exists for tangible personal property (including semiconductor cleanrooms) that is used primarily in the integrated process of designing, developing, manufacturing, or testing a semiconductor product, a semiconductor manufacturing process or subprocess or semiconductor equipment.

Other Virginia R&D Tax Incentives

Local Tangible Personal Property Tax

A separate classification of tangible personal property tax exists for tangible personal property used in a research and development business. Localities are authorized to provide a lower rate than the general rate of tangible personal property tax for such property.

A separate classification of tangible personal property tax exists for equipment used primarily for research, development, production, or provision of biotechnology for the purpose of developing or providing products or processes for specific commercial or public purposes, including, but not limited to, medical, pharmaceutical, nutritional, and other health-related purposes; agricultural purposes; or environmental purposes but not for human cloning purposes.

Localities are authorized to provide a lower rate than the general rate of tangible personal property tax for such property.

Other Virginia R&D Tax Incentives

Local Business, Professional, and Occupational License (BPOL) Tax

Any person, firm, or corporation designated as the principal or prime contractor receiving identifiable federal appropriations for research and development services in the areas of (i) computer and electronic systems, (ii) computer software, (iii) applied sciences, (iv) economic and social sciences, and (v) electronic and physical sciences shall be subject to a license tax rate not to exceed three cents per \$100 of such federal funds received in payment of such contracts. In general the BPOL tax rate for contractors is sixteen cents per \$100 of gross receipts.

- This is not required for any county operating under the county manager plan of government. Arlington County is the only county currently operating under the county manager plan of government.

Other Virginia R&D Tax Incentives

Local Zone Incentives

- Any city, county or town may establish one or more technology zones and may grant tax incentives, including reductions of user fees and any type of gross receipts tax, and provide certain regulatory flexibility in a technology zone.
- Any city, county or town may adopt a local enterprise zone development taxation program, that allows all or a specified percentage of real estate tax, machinery and tools tax or both, to be used to provide law-enforcement and other governmental services, financing transportation projects, grants to chambers of commerce and similar organizations, or to make grants to any industrial development authority.

Tax Incentives of Other States

- 45 other states provide some form of income tax incentive.
- Those that do not are AK, SD, TN, WY, and the District of Columbia.

Tax Incentives of Other States

- A total of 90 R&D-related income tax incentives are offered by 42 states
- Of these, 56 are tax credits directly related to expenditures for R&D
 - 45 are general R&D credits
 - 11 are targeted toward a specific industry, such as solar liquid fuels

Tax Incentives of Other States

- 31 R&D-related income tax credits are offered to help stimulate investment
 - 18 are offered to incentivize investment in specific businesses
 - 9 are offered to incentivize improvement of facilities
 - 4 are offered to encourage investments in institutions of higher learning

Tax Incentives of Other States

- 3 R&D-related income tax incentives provide a reduction in taxable income
 - These include deductions for income from research and development activities, for income from royalties, and for expenditures incurred for the construction of research and development facilities

Tax Incentives of Other States

- A total of 50 R&D-related sales tax incentives are offered by 34 states and 1 state offers an excise tax incentive
- Of these, 44 are exemptions, 6 are refunds or rebates, and 1 is a tax credit for sales tax paid
 - 22 are general R&D sales tax incentives
 - 21 are targeted toward specific industries or entities, such as hydrogen cells or nonprofit organizations
 - 8 are targeted toward businesses in specified zones

Tax Incentives of Other States

- 13 R&D-related personal property tax exemptions are offered by 12 states
 - 5 are general R&D personal property tax incentives
 - 6 are targeted toward specific industries or entities, such as manufacturing or space laboratories
 - 2 are targeted toward businesses in specified zones

Tax Incentives of Other States

- Finally, 6 R&D-related real property tax exemptions are offered by 6 states
 - 4 are general R&D personal property tax incentives
 - 1 is targeted toward the manufacturing industry
 - 1 is targeted toward businesses in specified zones